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FISCAL IMPACT STATEMENT

LS 7125 | **NOTE PREPARED:** Jan 12, 2013
BILL NUMBER: HB 1354 | **BILL AMENDED:**

SUBJECT: Enterprise Zones.

FIRST AUTHOR: Rep. Dermody | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: This bill establishes 4 programs to assist businesses within Enterprise Zones (EZ).

1. This bill provides a state Sales and Use Tax (SUT) credit for the purchase of building materials for the purpose of the redevelopment or rehabilitation of a business or residence in an EZ. The purchase must be made by or behalf of a taxpayer who owns real property in a EZ or from a person whose business is within an EZ or a city in which an EZ is located.
2. It provides retail merchants located in an EZ with an additional vendor allowance equal to 1% of the merchants sales tax liability.
3. It provides individuals with an income tax deduction equal to the amount of qualified increase EZ adjusted gross income (AGI) received by the individual during the taxable year. The calculation of the deduction includes the individual's distributive share of a pass through entity's qualified increased EZ AGI.)
4. It creates a tax credit for jobs created at locations within an EZ.

Effective Date: July 1, 2013; January 1, 2014.

Summary of NET State Impact: The potential impact of the new EZ tax provisions is as follows.

Building Materials Sales Tax Exemption: The credit against a taxpayer's SUT liability for the purchase of qualified building materials for EZ projects has an indeterminable revenue loss that could potentially be significant.

Increased Vendor Allowance: The additional 1% collection allowance to retail merchants located in an EZ could potentially result in an annual revenue loss of $1 M. The revenue loss could be significantly higher under certain circumstances.

EZ AGI Deduction: The AGI deduction for the difference between an EZ business's annual income and base income before the EZ was established would result in an indeterminable but significant revenue loss.

Job Creation Credit: The tax credit could potentially lead to an annual revenue loss ranging from $1.2 M to $2.4 M.

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR will incur some administrative expenses relating to the revision of the tax form instructions and software programs to implement this bill. The DOR's current level of resources should be sufficient to implement the changes within the bill.

Indiana Economic Development Corporation (IEDC): The bill's requirements are within the agency's routine administrative functions and should be able to be implemented with no additional appropriations, assuming near customary agency staffing and resource levels.

Explanation of State Revenues: *Building Materials Sales Tax Exemption*: The bill establishes a credit against a taxpayer's SUT liability for the purchase of qualified building materials used to redevelop or rehabilitate a business or a residence in an EZ. The potential revenue loss from this exemption is indeterminable as data are not available regarding EZ improvement projects and purchases of building materials by EZ businesses. However, the revenue loss could potentially be significant.

The credit provided would be equal to:

(1) 100% of the SUT paid on the purchase of the qualified building materials if the materials are purchased from a business located within an EZ; or
(2) 50% of the SUT paid on the purchase of the qualified building materials if the materials are purchased from a business outside of the EZ but within the city in which the EZ is located.

For instance, if 40% of the cost of a $10,000,000 in improvement projects in an EZ is attributable to building materials, then the credit could potentially range from $140,000 to $280,000. This assumes that building materials were purchased either from businesses in the same city but outside the EZ or from EZ businesses. This credit applies to transactions made after June 30, 2013. The reduction to state revenue would likely begin in FY 2014.

Increased Vendor Allowance: The bill provides for an additional 1% collection allowance to retail merchants located in an EZ. This would increase their collection allowance to between 1.26% to 1.73% of the merchant's SUT. An analysis by LSA suggests that this provision could potentially reduce SUT revenue by an estimated $1 M annually. However, the actual revenue loss could be much greater depending on the number of retail businesses that have locations in EZs and outside EZs. If a retail business has a location in an EZ and multiple locations across the state, and files a consolidated SUT return, they could presumably apply the increased vendor collection allowance to their statewide SUT liability.

Under current law, the vendor allowance percentage is determined by the SUT liability in the prior state fiscal year.

(1) If a merchant’s SUT liability is below $60,000, their allowance is 0.73%.
(2) If a merchant’s SUT liability is between $60,000 and $600,000, their allowance is 0.53%
(3) If a merchant’s SUT liability is above $600,000 their allowance is 0.26%.

[Revenue from the state’s 7% SUT revenue is deposited in the state General Fund (99.848%), the Commuter Rail Service Fund (0.123%), and the Industrial Rail Service Fund (0.029%).]

EZ AGI Deduction: Under this bill, each taxable year, an individual taxpayer would be entitled to an AGI Tax deduction generally equal to the difference between: (1) the AGI derived by the taxpayer from sources within the EZ during the taxable year; and (2) the AGI derived by the taxpayer from sources within the area comprising the EZ in the taxable year before the EZ was designated. (If the taxpayer derived no income from EZ sources in the year before the EZ was designated, this base year income is equal to zero.) As data are unavailable on the earnings and sources of income of individuals and business entities with income producing operations in the EZs, the resultant revenue loss is indeterminable. However, the revenue loss could be substantial given that: (1) the deduction applies to any business (other than a regular “C” corporation) deriving income from sources in an EZ; (2) the deduction applies to individuals deriving income in EZs whether or not they reside in an EZ; (3) for some taxpayers, the deduction applies to a temporal difference in income that could straddle many years (depending upon EZ designation); and (4) for some taxpayers, the deduction would apply to all income derived from sources in an EZ. Since this change is effective beginning in tax year 2014, the fiscal impact could potentially begin in FY 2014 (due to changes in quarterly tax estimates).

The deduction would apply to individuals, sole proprietorship businesses, and income distributed to individuals from pass through entities (“S” corporations, partnerships, trusts, limited liability companies and partnerships). Thus, the bill would have the following two impacts on EZ businesses:

(1) An individual or business that did derive income from sources located in the area comprising the EZ prior to its designation would each year be entitled to deduct the increment of income attributable to its EZ sources in excess of this pre-EZ base year income amount.
(2) An individual or business that did not derive income from sources located in the area comprising the EZ prior to its designation would each year be entitled to deduct all of the income derived from sources in the EZ.

The deduction would apply to the following types of income derived from sources within the EZ: (1) income from real property and tangible personal property located in the EZ; (2) income from doing business in the EZ; (3) compensation for profession or trade services rendered within the EZ; and (4) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property having a situs in the EZ. The bill provides for a method of apportioning income to the EZ for individuals or businesses that can not separate income earned from operations inside and outside of the EZ.

Job Creation Credit: The EZ Job Creation Credit is a refundable tax credit equal to $1,500 for each new employee employed by the taxpayer at an EZ location during the taxable year. Based on an LSA analysis of EZ employment patterns, the estimated revenue loss associated with this credit may be between $1.2 M and $2.4 M beginning in FY 2014.

A new employee is an employee first employed by the taxpayer at the EZ location during the taxable year. It does not include an employee in a position previously held by another employee or an employee previously employed elsewhere in Indiana by another person or entity having a business relationship with the taxpayer.

Since the credit is effective beginning in tax year 2014, the fiscal impact could potentially begin in FY 2014 (due to changes in quarterly tax estimates). The credit can be used to offset tax liabilities for Individual Adjusted Gross Income (AGI), Corporate AGI, Financial Institutions, and Insurance Premiums Taxes. Revenue collected from those taxes is deposited in the state General Fund. The revenue to the state General Fund would be reduced by the amount of the credits.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the deduction for incremental business income earned in Ezs would decrease taxable income, counties with EZs and that impose local option income taxes could potentially experience a decrease in revenue from these taxes..

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation.

Local Agencies Affected: Counties with a local option income tax; Local units that receive Sales Tax revenue.

Information Sources: Global Insights - Indiana Economic Forecast, December 2012. LSA: *Indiana's Enterprise Zones,* June 15, 2005.

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